RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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**Jan. 27, 1999** **LETTER 1270**

*"In a bear market, whatever can go wrong, will go wrong."* -- Richard Russell

**OPENING COMMENT:** The public is bullish. They're loaded with mutual funds and stocks and they remain extremely bullish. The "buy the dip" philosophy is deeply ingrained in the public's psyche, and that bullish philosophy will not disappear in a hurry. But the bear is patient. **He'll keep slowly chipping away at the bullishness until finally something in the collective unconscience of the market will snap.** That hasn't happened yet -- not by a long shot. But somewhere ahead this stubborn bullishness will fade (maybe with the net stocks).

Consider the following -- from a psychological standpoint, if you're loaded with stocks, if most of your assets are in stocks, it's embarrassing, no, it's downright **frightening,** to even think about reversing and turning bearish. It means that suddenly you must deal with that dreaded realization -- the realization that you're on the wrong side of the market. It's a very difficult transition. For the average investor, it's almost impossible. He will take a huge loss rather than admit to himself that he's been wrong.

**BULL & BEAR:** The bull is a S.O.B. He moves the market up while keeping the majority (particularly old-timers and the value-minded) fearful, grumpy, frustrated -- and out of the market. How does the bull do it? He does it by generating unpleasant news, vicious rumors, scary stories, warnings from analysts. They call the process "climbing a wall of worry." That process continues until the third or final phase of the bull market. That's the phase where the market becomes frothy. At this point everything turns rosy, optimism rises, rises, rises, until finally it's widely agreed that "this is a new era," and "the sky's the limit." I thought of this as I read a piece on the op-ed page of the January 11 *WSJ*. Listen, this market isn't expensive, claims the writer, and consider this -- "isn't it possible that historic market levels were too low?" Now there's an idea -- this economist is suggesting that all the markets of the last 100 years were under-valued. Gosh, why didn't I think of that?

## *Overvalued? Stocks' Price Is Finally Right*

By MICHAEL EDESESS

As the Dow Jones Industrial Average soars above 9500, market prices are being compared unfavorably to their historic levels. Today's market, the argument goes, is

Just as the bull is a S.O.B., the bear is a dirty devil. He's born in the midst of the frothiest period of the preceding bull market. Then, as the market begins its subtle deterioration, the bear does all he can to generate good news. "Everything's fine, stocks aren't overvalued." "Never mind the breadth." "This time it really is different." "Buy 'em on any dip." You see, the bear has no conscience; he wants to take stocks down while keeping as many investors in the market as possible. A bear market declines amid a constant barrage of hope and optimism. Oh, I forgot, the bear has one other weapon, and it's called the violent rally. Anytime investors get too worried, why the bear gives 'em a rally. But despite periodic rallies, the market keeps going down -- down, until the final irony. The final irony is that when the bear market sinks into its third and last phase, the public finally believes it's a bear market. So just when they should be buying stocks, the public will be dumping whatever stocks they have left. I remember this process only too well. It occurred back in 1974. Towards the end of that year the Dow broke 600 heading for its final low of 577. But in the midst of that fabulous buying area, what were the leading analysts saying? They were saying "Dow 250, Dow 200 -- it's the end of Wall Street and the stock market as we know it." Yeah, the bear is one dirty devil. But that's life in the investment business.

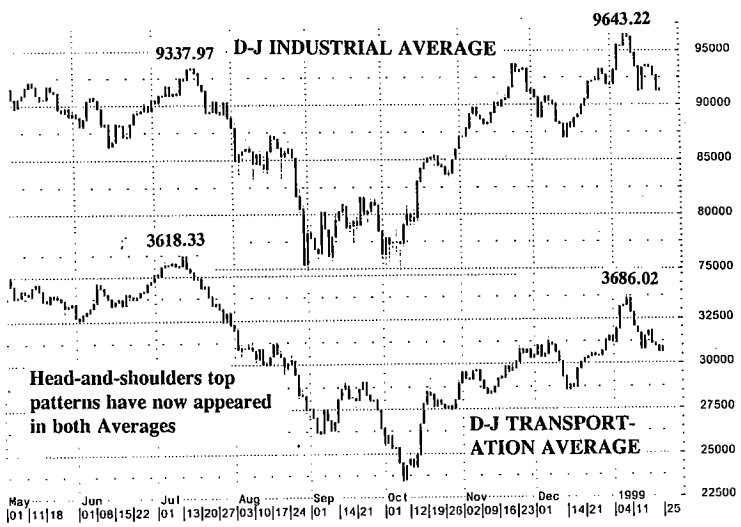
**Jan. 15 DJIA 9340.55; PTI 5362; A-D Ratio +5.04**
**Jan. 22 DJIA 9120.67; PTI 5359; A-D Ratio +4.63**
**Dow Yield: 1.67%; Dow Price/Earnings: 24.0**
**Dow 144-day MA: 8693; Dow 34-day MA: 9166**
**Dow Times Book Value: 5.72; PTI 89-day MA: 5332**
**Percentage of Undervalued Blue-chips: 4%**
**Gold 34-day MA: 291**

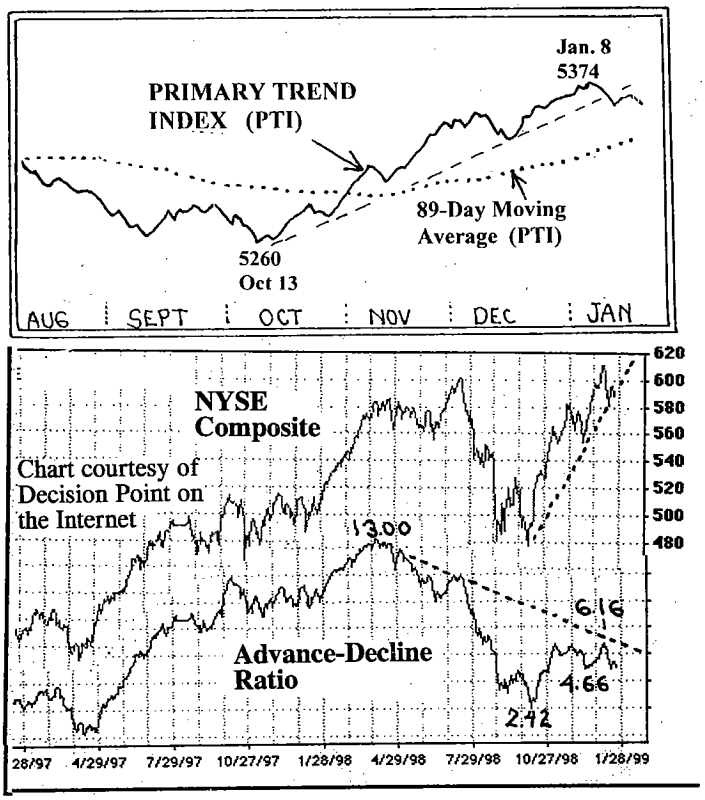
**THE MARKET:** I've discussed in Letter after Letter why, under Dow Theory, we're in a primary bear market. So I'll be brief in this Letter. The bear market started on April 16, 1998. That was the day on which the two Averages, D-J Industrials and Transports, recorded their last highs **together**. At no point since then have **both** Averages recorded higher highs.

The poor action of the Transports after April bothered me, and I said so repeatedly. At the same time the breadth started to deteriorate, and I began to suspect that a bear market had started. Wondering, however, is not the same as proof.

Proof came on August 4. On that day the Industrials smashed below their preceding reaction lows on heavy volume; in doing so they confirmed the previous bearish action of the Transports. On August 4 a primary bear market was signaled under Dow Theory.

But huge bull markets don't die quickly -- not by a long shot. Despite the continuing dismal performance of the advance-






decline ratio, the Dow continued to rally along with the S&P. The Dow and the S&P surged to new highs -- and spurred by Internet mania, the Nasdaq joined them.

Let me amplify a bit on the advance-decline ratio. In my experience, the relationship of the Dow to both the Transports and the A-D ratio are the **most important technical relationships in the market.** I have compared the A-D ratio with the water in a bathtub. In a bear market we have a situation where the plug is pulled, and the water is slowly running out of the tub. I liken the Averages to floating soap bars. The soap can bob up and down, but the bathtub plug has been pulled, and regardless of what the soap does, the water continues to run out of the tub.

Let me describe the A-D action another way. If, on a **continuing trend basis,** 40% of the stocks on the NYSE are advancing and 60% are declining, the Dow can do anything it wants -- but the market is weakening, and ultimately it will be heading down. And the Dow (in due time) will follow the majority of stocks. Once the Dow decides to follow the majority, the bear market is on in full, and Wall Street and the public will be forced to confront reality.

OK, let's examine the A-D situation in the light of recent and current action. The A-D ratio topped out last **April 3 at 13.00.** From there the A-D headed steadily down. Four months later, on October 8, the A-D ratio struck a low of **2.42** (see page 2 chart). Next came a rally, first to the November 6 high of 6.09, then a second rally that ended at a slightly higher level of **6.16** on January 6.

At the January peak of 6.16 the A-D ratio had recouped only 35.3% of its April-to-October bear market losses -- a very **sub-standard recovery.** The dismal A-D action casts a bearish technical pall over the whole market picture.

Following the January 6 peak, the A-D ratio saw more bearish action. On January 14 the A-D ratio declined to a low of 4.66. As you can see on the page 2 chart, this exactly equaled the low of last December. From there the market pushed up weakly. But each breadth rally appears to be weaker than the preceding.

Why have I spent so much time on the A-D ratio? I've done it because I believe the Dow/A-D ratio relationship is telling us a vital **story.** The divergence between the Dow and the A-D has created a **vacuum,** and the longer this vacuum is in existence and the wider it grows, the greater pressure on the market to fill the vacuum.

Ultimately, the continuing weak breadth will wear out the bullish buyers. In due time, the deteriorating, non-confirming breadth will break the back of the bull. At that time, the bear will emerge with full force. So far, we've seen only hints of the bear. His real strength, his real fury, lies ahead.

**PTI:** The instrument that has been of greatest value in defining the intermediate direction of this market has been the PTI. That's because the PTI doesn't care about values, over-bought or over-sold conditions or anything else - except direction. The PTI continues to hold above its 89-day moving average; thus it remains in its bullish mode. But note that I have drawn a rising trendline (dashed line) starting from the Oct. 13 low of 5260. The PTI has held above this trendline for four months. However, last week the PTI broke below this trendline, a first hint of possible trouble. The PTI is now only 27 points above its 89-day MA.

**THE FORECAST:** The stock market does not operate in a mindless haze. The Averages are constantly adjusting to conditions and earnings that they "see" in the period ahead. How far ahead? Sometimes the market's vision is limited to a few months, sometimes the market's crystal ball sees as much as a year ahead or even longer.

Today's market, as interpreted under Dow Theory, is saying that business conditions in 1999 will be deteriorating. The Dow Theory doesn't tell us how much deterioration lies ahead, but maybe that's where Fed Chairman Greenspan comes in. The Chairman assures us (or is he assuring himself?) that any slowing in the US will be moderate. Well, maybe. But if the bear comes out of his lair, fully out of his lair, the situation may become just a bit worse than Mr. Greenspan's "moderate" forecast.

> ***Fed Chief Says Any Slowing In U.S. Will Be Moderate***
>
> *By a* WALL STREET JOURNAL *Staff Reporter*
>
> HONG KONG—Federal Reserve Chairman Alan Greenspan told a gathering of central bankers here that any slowdown in the U.S. economy will be relatively moderate, according to the general manager of the Bank for International Settlements.

I've said this before, but I'll repeat it. There are two things that Fed Chairman Greenspan cannot tolerate. One is a full-fledged bear market. The second is a full-fledged recession (of course, a full-fledged bear market would almost guarantee a full-fledged recession).

Why, what's wrong with either of the above? What's wrong is that never in all history has the US public been as fully invested in stocks as now. Savings are now negative (people are spending more than they are saving), but various experts are telling us that this is not a problem because today the public has a different kind of savings; the "new savings" are in the capital gains of the stocks they own. So Mr. Greenspan must be wondering what would happen if those capital gains turn to losses in a big bad bear market. I'm sure that Greenspan has concluded that gains turning to losses would be a disaster, and to that end he's committed to fighting a bear market with all the power and prestige that the Fed can muster.

Of course, I've always contended that the primary trend of the market is more powerful than the Fed, the Treasury, the

President and the Congress taken together. At any rate, it will be instructive to see how it all turns out.

**WHERE AM I?** I'll be honest -- subscriptions here have been running at record levels, and I find myself wondering why. I wonder why because let's face it, Dow Theory Letters isn't a tout sheet, and I don't offer "15 stocks to double in the next six months," and I don't run ads predicting that "the Dow is going to 10000 in '99." The fact is that I only recommend stocks when I believe stocks represent real values, and despite the recent explosion in equities, I haven't felt that stocks represent great or even decent values. Furthermore, I haven't been convinced that the Dow is going to 10000 this year or next year or in 2001. In fact, I've doubted it.

One thing I'm always cognizant of is **risk.** I don't gamble in Las Vegas or Atlantic City, I don't play poker with the boys, and I don't buy stocks when the average yield on blue-chip stocks is down to 1.2%. I learned long ago that missing a market advance is very different than taking a loss. Furthermore (old-fashioned me), I like income, I believe in compounding, I've learned the benefit of patience, and I'm well aware of the danger in running with the crowd.

I have a group (7100 to be exact) of what I believe are the smartest and most knowledgeable subscribers in the nation. But here's the funny part of it -- I doubt if a majority of my subscribers invest on the basis of my recommendations or suggestions. I believe that most of my subscribers do their own thing and do their own thinking; they want information, concepts, history, intelligent thinking -- in short, information and opinions that might help them in handling their own finances. But for the ultimate advice, for the ideal way of making you a millionaire, for the path to guaranteed riches, I'm not sure you can find it here (unless, of course, you've got the patience and self-control to follow a long-term policy of compounding).

**Question:** Is the so-called "January Barometer" worth anything?

**Answer:** I dunno. As I noted in a previous Letter, there seems to be a built-in optimism during the last few weeks of December. But in January investors sober up; in January investors take a serious look at the year ahead and, based on their best estimates, they adjust their holdings accordingly. This gives way to the thesis that "as January goes, so goes the year." Using the S&P 500, the January barometer has worked for 43 of the last 48 years. Returning to the present, the S&P closed on Dec. 31 at **1229.23.** If the S&P on January 31 closes above that figure, the January barometer will be saying "bull year 1999." If below that figure, it will be saying "bear year 1999." Since I believe we're in a bear market, I would give more credence to a bearish reading for the January barometer than I would a bullish reading. Finally, it's well to remember that nobody has ever come up with the perfect formula for beating the market. I've been looking for 45 years, and I haven't found it yet. Yeah, I keep looking.

**INVESTMENT POSITION:** I've said this repeatedly, but I want to say it once more. In this business you can do a lot of things wrong -- but the one thing you **cannot do is take "the big loss."** The big loss is a killer, and if you let it hit you, it's demoralizing to both your psyche and your bank account. Furthermore, it's statistically very hard to recoup a loss of say 20% or 30% of your assets, believe me it is.

And that's the reason I always warn subscribers not to fool with the bear. He's out to take your money. Yeah, I know Amazon.com has been a beaut; I know Yahoo has been a super-winner. But I'm an investor, not an adventurer, and I invest in bull markets. In bear markets, I move into the storm cellar, regardless of whether some group or some stock is acting like a Roman Candle.

I don't know if I've found the one ultimate safest place to be during a bear market, but my instinct is to opt for US Treasury bills with maturities from 91-days to maybe a year or two years. You can bet that (if they can do it) the Fed will knock interest rates to low, low levels as this bear market progresses. But problem -- the dollar faces tough competition today, and if the dollar starts to swoon, our foreign friends will dump their Treasury holdings, thereby driving bond prices down and pushing bond rates up. You see, shipping our debt all over the world was great as long as we could guarantee that our creditors would hold that debt. Now with euro competition and a strengthening yen, well, who knows?

I'm watching the show in T-bills and notes. And remember, nobody can afford "the big hit."

**NOTE & QUOTES: Clinton:** I'm sure you heard his State of the Union Speech. And all the while I kept thinking, This guy is in another world. What he's really saying is -- "Don't bug me with this petty impeachment nonsense, I'm doing the people's work. The people love me, I'm doing what America's voters hired me to do." And on he went, presenting a trillion dollars worth of ideas and concepts. At the same time, I thought Clinton was taunting the Republicans and all those who cannot stand him. Here he was, talking the talk, daring, smiling, literally spitting in the face of those Senators who were in the act of deciding his fate. Amazing, unbelievable. I found myself wondering -- can this guy really be sane?

* *

Greenspan -- I have to have a soft spot for him. He received his BA and his MA (in economics) from NYU, of which I'm also an alumnus. Greenspan started out as a swing musician (saxophone), later did accounting, then to his own advisory firm, and finally to the Fed. Greenspan is 72, I'm 74. Did I see or know Greenspan at NYU? Nope.

* *

At its recent high, Yahoo, which has never made a nickel and is heading for increased competition, was valued at more than General Motors. Insanity? Nah, just "irrational exuberance."

* *

From *Market Logic* [(800)442-9000]: "1998 was one of the most disparate years in market history. The S&P 500 rose 28%, while our NYSE Total Return Index of all Big Board stocks was up just 1% and is still 8% below the bull market high set last April . . . The S&P 500, which is now the most popular benchmark of stock market performance, is priced at 33½ times earnings. Even stripping away the 10% earnings decline of the last year, the current S&P level is 30 times the cyclical peak of earnings one year ago. No bull market in this century exceeded 25 times earnings at the peak, so this has clearly gone stratospheric."

* *

**The Same Ol' Story:** A country lives it up; its politicians give electorate everything they desire -- and more. The country's currency is pegged to the dollar. But investors, both domestic and foreign, are worried about the country's profligacy, and they continue to pull their money out of the country. The country's reserves decline, and it is seen that the country's currency is drastically overvalued compared with the dollar. A crisis atmosphere prevails. Interest rates are raised sky-high in an effort to keep money and savings from fleeing the country. The president announces that under no circumstances will his nation devalue. The IMF, in an effort to stem the crisis, lends the nation $40 million and presents a list of stringent economic demands. The politicians take the money, but (for obvious political reasons) they can't meet the IMF's restrictive demands;

unemployment rises and business sinks. A few months later the country's president announces a devaluation, the IMF's money (already shipped out of the country to safe overseas banks) disappears. Welcome to the new world of the late-'90s. Welcome to Thailand, Indonesia, Brazil and other ports-of-call to come.

* *

**Dollar:** All eyes (at least my eyes) are on the "good ol' Yankee dollar." The dollar's been in decline. Worth almost 150 yen a year ago, it's now worth 114 yen. Over the past two years, the dollar is down against the main European currencies. The dollar now has a new competitor -- the euro. Over the years the US has spread dollars by the billions all over the world. The world wanted dollars, but that may now be changing. After Brazil's devaluation two weeks ago the dollar slipped. World holders of dollars may be thinking with the US doing 20% of its foreign trade with South America, the dollar may be in danger. They also note that the US has been running negative trade balances for years. A US negative balance that has been running around $200 billion might reach as high as $300 billion this year due to the current American buying binge and the influx of imports to US shores. The Japanese have cut down their investing in the US. With Japanese interest rates rising and US rates declining, more money is staying in Japan. Japan just doesn't need as many dollars as it used to. Finally, nobody's saying it out loud, but Europe and probably Japan are tired of trading merchandise for US paper, paper which costs the US nothing except the expense of printing it. That, I think, is one of the main reasons that Europe developed the euro. They're tired of depending on the dollar alone for their reserves. They want their own money. They want money that hasn't got trillions of debt (US national debt is $5.6 trillion) behind it. They want money with a positive trade balance behind it. Thus, the euro. One last item: if the dollar does turn weak, a weak dollar will force US interest rates higher if for no other reason than foreign holders of US bonds will dump those bonds in order to protect their assets. For all these reasons, it would not surprise me to see the story of the year in 1999 being **the dollar.**

* *

My friend, Gary Shilling, is one economist who says and writes what he means, and he's able to because he owns his own firm and therefore is beholden only to his subscribers. Gary believes we are in for "long-term deflation." He writes, "Yet few believe that deflation is on the way. Most economists think that price declines are transitory, largely confined to internationally-traded commodities, and highly unlikely to pervade the entire economy, especially the dominant service sector which they see as immune to competition. Consumers are even more convinced that deflation is impossible . . . Indeed, lifetimes of chronic inflation have a lot to do with Americans' unwillingness to accept the virtual disappearance of price increases on average . . . Many businesses are now under excruciating pressure to maintain, even cut, their selling prices, but they'll be fully aware that deflation has replaced inflation when they see their costs decline in areas they never dreamed possible . . . Deflation, then, is not widely understood or anticipated, but if we're right, it's coming. And it will be long-lasting, at least until the next war . . . recall that inflation is a war-time phenomenon with deflation reigning during years of peace . . . Only now, for the first time since the 1930s, the world is at peace, the time when deflation prevails." **Russell Comment:** Peace and world over-production, we've got 'em both. But real all-out global deflation, the kind Gary is talking about, is not here -- yet. However, I'm wondering whether the **dismal action of gold** isn't confirming Shilling's global deflation thesis. (Note: Gary's new book, "Deflation," is now in the book stores.)

* *

Do you watch CNBC (almost everybody, it seems, does)? This station provides a day-long market hype. Everything on CNBC seems to come up roses. If the Dow is down 600 points intra-day and closes down 200, a commentator will talk about "the market closing well off the lows." Everything on CNBC is how this or that closed "off the lows." **Russell Comment:** What happens during the day is interesting, but it's how the market (and any given stock) actually **closes** that's important.

* *

Goldman Sachs is the most successful large trading organization on Wall Street. And months ago they were supposed to let the public in on their success via a public offering of their stock. But two weeks ago Jon Corzine stepped down as Goldman's co-chief executive. Significantly, Corzine was the chief advocate of a public offering for Goldman. Now three other Goldman guys have taken over the lead, and I wonder whether Goldman is really "going public." Why do I wonder? First, Goldman is a trading house, and if they go public there'll be a lot more inspection and publicity regarding just what Goldman is doing, a situation that few traders love. Second, I wonder whether the new top-guys are thinking, "Maybe we're heading into a bear market, and if so, why would we want our stock to be publicly traded?" **Russell Comment:** During bear markets, private companies have a much better time of it, because they don't have to watch their stocks (which are quoted all day long) go down the drain with the rest of the stocks on the various exchanges.

* *

Finally, after months of rumors, Monica has sold her book, "Monica's Story," to St. Martin's Press (they got the US rights for a mere $600,000). Problems: All the "good stuff" is out, but who knows, maybe there's more? Second problem is Monica's immunity agreement with Ken Starr. According to *Entertainment Weekly*, the best case scenario is "it becomes a best seller and Monica gets her wish -- a job where she doesn't have to answer phones. Worst case -- the tome ends up in the clearance pile of Buck-a-Book and Monica at the Krispy Kreme."

* *

There are rumors (suggestions?) that there should be one North American currency, the dollar, which would be the currency of the US, Canada and Mexico. Already, a lot of Mexico's commerce is via the dollar, and Canada is hardly crazy about its own dollar (pictured with a loon on it) which they disparagingly call "the loonie." Could it happen, perhaps as an offset to the euro? I wouldn't bet against it. Second rumor: Argentina might drop its own currency and move to the dollar as their official currency.

* *

I started publishing Dow Theory Letters in 1958. Ten years after I began publishing, I was faced with a true stock market mania. The mania was centered in the hot, "must-own" technology stocks of 1968. The stock market had topped out in 1966, preparatory to a long, frustrating, complex bear market, which was not fated to end until December, 1974. In a recent Letter I described the movie stock mania of 1930, a mania that occurred in the year following the crash of '29. Interestingly, the technology stock mania of 1968 began a year after the market top of 1966. The box below shows what happened to the mania stocks of 1968. To put it succinctly, it wasn't pretty. Along these lines, you have to wonder what is fated ahead for the Internet stocks, the mania stocks of today. Mind you, there's no question about the fundamental importance of the net. The questions are (1) will these stocks make any real money? (2) How much competition will they face? And (3) finally, how the whole net situation will

## The 'Must-Own' Techs — of 1968

Thirty years ago, these technology stocks were the darlings of Wall Street—only to crash by 1970. A look at the stocks' peak-to-trough declines and their price-to-earnings ratios at the peaks:

| Stock | 1968 high | 1970 low | Pctg. drop | P/E at high |
|---|---|---|---|---|
| Fairchild Camera | $102.00 | $18.00 | **-82%** | 443 |
| Teledyne | 72.00 | 13.00 | **-82** | 42 |
| Control Data | 163.00 | 28.00 | **-83** | 54 |
| Mohawk Data | 111.00 | 18.00 | **-84** | 285 |
| Electronic Data | 162.00 | 24.00 | **-85** | 352 |
| Optical Scanning | 146.00 | 16.00 | **-89** | 200 |
| Itek | 172.00 | 17.00 | **-90** | 71 |
| University Computing | 186.00 | 13.00 | **-93** | 118 |

Source: Dun's magazine (1971)

develop over time? I'm reasonably certain of one thing -- the net is going to kill the middleman and many retailers. Item: OnSale, an online retailer, announces that it will sell new PCs and accessories at wholesale prices. But other net retailers already are beating some of OnSale's prices.

* *

Japan continues in the throes of an horrendous primary bear market. While not as bad as the great US bear market of 1929-'32, it is nevertheless a killer. This run-down of annual closings gives you some idea of just how bad the Japanese bear market that began in 1989 has been (figures courtesy of *ISI*).

| | NIKKEI YEAR-END CLOSINGS | | |
|---|---|---|---|
| 1989 | 38916 | 1995 | 19868 |
| 1990 | 23849 | 1996 | 19361 |
| 1991 | 22984 | 1997 | 15259 |
| 1992 | 16925 | 1998 | 13842 |
| | | 1993 | 17417 |
| | | 1994 | 19634 |

* *

The medical profession continues its frantic battle against **chelation**. Chelation, as subscribers must know by now, entails intravenous injections of EDTA as a method of clearing plaque from the blood vessels. I've already had well over 100 of these treatments, and I can attest to its effectiveness as can dozens of my subscribers whose letters I have on file. The FDA has for years fought doctors who have provided chelation treatments for their patients. Now, believe it or not, the FTC (Federal Trade Commission) has attacked the American Board of Chelation Therapy for supposedly making assertions that chelation therapy is beneficial to arteriosclerosis and vascular disease. Why is the government directing all this time and energy against chelation? I can only guess that behind it is the **fear** by the medical establishment that chelation works -- and if news gets out that it works it would upset the entire multi-billion dollar "heart business," plus costing hospitals and physicians a fortune in lost fees. To my many subscribers who have benefited from chelation therapy, may I suggest that you write your experiences and opinions to the Federal Trade Commission, Office of the Secretary, Room 159, 600 Pennsylvania Avenue NW, Washington DC 20580. Finally, for subscribers who have even a hint of heart trouble, I suggest you read about chelation on the net or go to your local health store and buy a book on chelation. One more thing, if your doctor tells you chelation is nonsense, ask him if he's talking from personal experience or whether he's simply repeating hearsay.

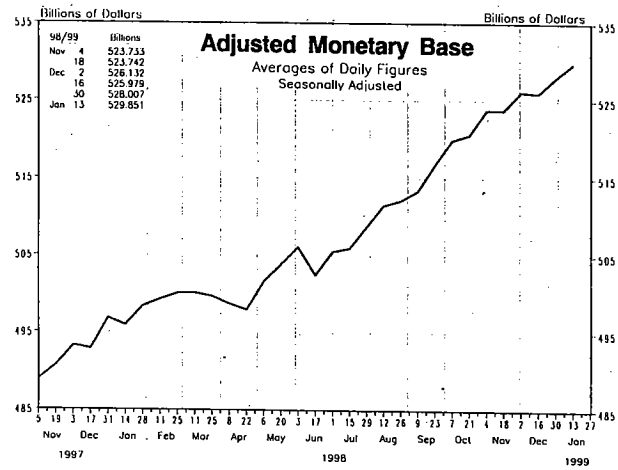
Subscribers may wonder how I dare question the honesty of the medical fraternity, doctors who have all taken the sacred Hippocratic oath. It's obvious that the vast majority of physicians are very honest and are there to help their patients -- but the fact is that medicine today is a business. Behind pure medicine lies the hospital system and the drug industry, both of which involve multi-billions of dollars and millions of jobs. Anything that fundamentally puts all that in jeopardy is going to be attacked, and that's what's happening to chelation. But if chelation works, and I'm convinced that it does, then that's the simple truth, and truth ultimately will overpower all opposition. Thus, it's only a matter of time until chelation becomes widely accepted and widely used, despite the best efforts of the FDA, the FTC and the medical fraternity.

* *

The sports world (and Wall Street) gasped when it was learned that the Washington Redskins football team (with its stadium) was sold for a fantastic $800 million, the highest price ever paid for a sports franchise. I have to wonder what the buyers were thinking about. If I invest that same $800 million in 30-year T-bonds at 5.3%, I would receive $42.4 million (free of state taxes) every year without any aggravation, without any worries, without having to deal with unions, fat salaries, etc. Can the new owners guarantee that they'll make $42 million out of the Redskins year after year? It's all an ego trip, it's got to be. Or it's this -- the idea of basic values has been lost in this era of massive Fed-sponsored liquidity and wild speculation.

* *

What, you doubt that the Fed hasn't pushed the "pedal to the metal?" This is from the St. Louis Fed's weekly chart book. It shows the Adjusted Monetary Base going through the roof. The Fed is playing central bank to the world, on the dubious thesis that if the Fed can "save" the world, it will keep the US bull market going. Good luck, Greenspan and company. Oh yes, just in case you're still worried, Mr. Greenspan says that even if the economy does slow this year, it will be "moderate." Thank goodness.

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The **NYSE** is going to expand, and happily, it's going to expand right in good old New York. The Exchange will move across the street, opposite its current headquarters in Manhattan, and the new facility will include a 50,000 square foot trading floor plus a police sub-station. What happened? Well, the city of New York and NY State gave the Exchange roughly $600 million in incentives, all in an effort to keep the Exchange in the City. And why not, who wants to drive to Jersey every day, just to make a living? Question: Is it coincidence that the Exchange wants to expand just when the bear is awakening and just when more and more people will be doing their transactions on the Internet?

* *

One of the most widely-followed "cycles" is the so-called "Presidential Cycle," which comes around during the pre-election year (i.e., the third year) of the four-year presidential term. This chart was published by my old friend from Canada, Ian McAvity of *Deliberations* (PO Box 40097, Tucson, AZ 85717). Note that since 1935 there has been only one down-year

***Presidential Election Year Cycles Illustrated***

***1935 - 1998, Year over Year % Change in S&P 500***

***S&P 500 Monthly Close Values, (December Year End Basis)***

| Year 3 | | Year 4 | | Year 1 | | Year 2 | | From Year 1 |
|---|---|---|---|---|---|---|---|---|
| Pre-Election | | Election | | Post-Election | | *Mid Term* | | President |
| *1935* | 42.3 | *1936* | 27.9 | *1937* | **-38.6** | *1938* | 25.2 | FDR |
| *1939* | **-5.5** | *1940* | **-15.3** | *1941* | **-17.9** | *1942* | 12.4 | FDR |
| *1943* | 19.5 | *1944* | 13.8 | *1945* | 30.7 | *1946* | **-11.9** | TRUMAN |
| *1947* | 0.0 | *1948* | **-0.7** | *1949* | 10.3 | *1950* | 21.8 | TRUMAN |
| *1951* | 16.5 | *1952* | 11.8 | *1953* | **-6.6** | *1954* | 45.0 | EISENHOWER |
| *1955* | 26.4 | *1956* | 2.6 | *1957* | **-14.3** | *1958* | 38.1 | EISENHOWER |
| *1959* | 8.3 | *1960* | **-2.8** | *1961* | 23.1 | *1962* | **-11.8** | JFK/LBJ |
| *1963* | 18.9 | *1964* | 13.0 | *1965* | 9.1 | *1966* | **-13.1** | LBJ |
| *1967* | 20.1 | *1968* | 7.7 | *1969* | **-11.4** | *1970* | 0.1 | NIXON |
| *1971* | 10.8 | *1972* | 15.6 | *1973* | **-17.4** | *1974* | **-29.7** | NIXON/FORD |
| *1975* | 31.6 | *1976* | 19.2 | *1977* | **-11.5** | *1978* | 1.1 | CARTER |
| *1979* | 12.3 | *1980* | 25.8 | *1981* | **-9.7** | *1982* | 14.8 | REAGAN |
| *1983* | 17.3 | *1984* | 1.4 | *1985* | 26.3 | *1986* | 14.6 | REAGAN |
| *1987* | 2.0 | *1988* | 12.4 | *1989* | 27.3 | *1990* | **-6.6** | BUSH |
| *1991* | 26.3 | *1992* | 4.5 | *1993* | 7.1 | *1994* | **-1.5** | CLINTON |
| *1995* | 34.1 | *1996* | 20.3 | *1997* | 31.0 | *1998* | 26.7 | CLINTON |
| *1999* | | *2000* | | *2001* | | 2002 | | |

in the presidential cycle and that was 1939. But 1939 was part of the 1937-'42 bear market. In other words, '39 was a bear market year. Again in 1947 there was an unchanged year, but '47 was part of the 1946-'49 bear market. So as I see it, the presidential cycle works beautifully during bull market years, but if a bear market is in force, well, be careful, the cycle may not work.

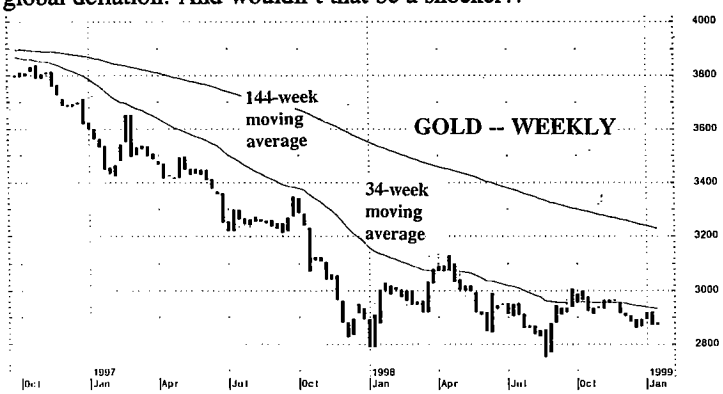
* *

**Europe:** Despite their euro, latest news and statistics indicate that the economies of the 11 European nations are stalling faster than the experts had expected even a few months ago. In Germany, which accounts for 25% of the euro zone's economic output, industrial production is slowing and Germany's already high unemployment rate is climbing again. In France, growth in the third quarter slowed to half a percent. In Italy, industrial production began to sag last November. All this puts pressure on the new European central bank to ease up on both monetary policy and interest rates. The problem with lowering rates is that Ireland and Spain, which are now doing well, could have problems with inflation.

**GOLD:** Nothing particularly new or exciting in the gold picture. I show here a weekly chart of gold, and I will say this -- it does appear that gold is trying to establish a major bottom. The extreme low for gold was hit last August 24, an intra-day low of 271.60. Gold hasn't been back there since.

The 34-week moving average for gold stands at 294, which I take as the first significant upside target. A more important upside target would be the October 5 closing high of 296.3. I'm always interested in the big even number, so my own feeling is that a move above 300 would suggest that "something is really happening" with gold. The higher moving average is the 144-week moving average which now stands at 322.8.

As noted in the Notes & Quotes column, it's just possible that the reluctant gold action is confirming Gary Shilling's thesis, that being that we're slowly but steadily moving into a period of global deflation. And wouldn't that be a shocker?!

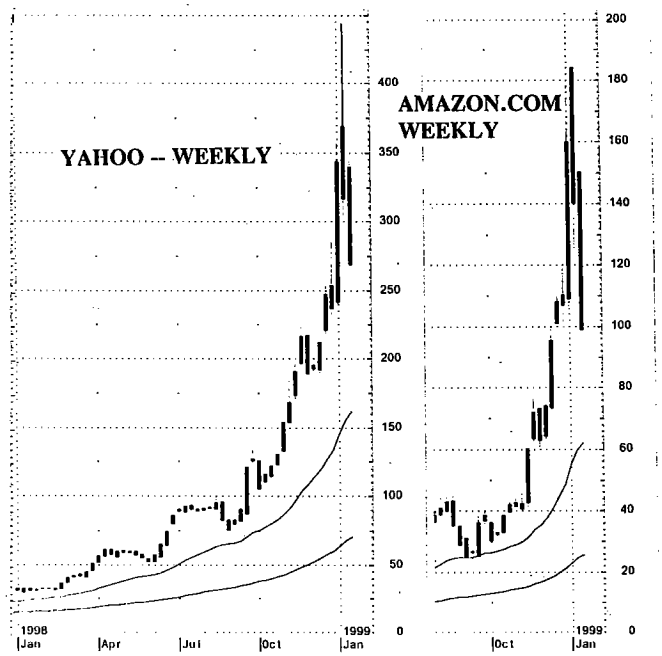


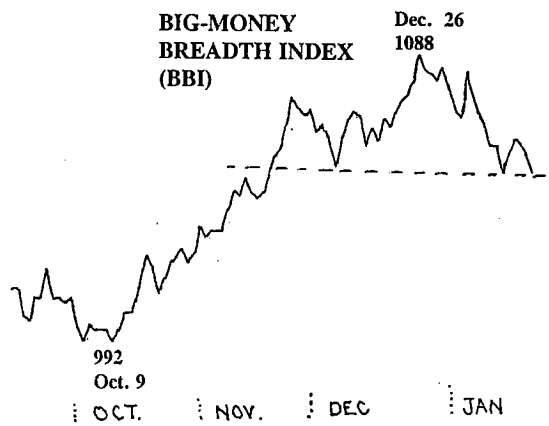

**NET STOCKS**: These are two of the best-known leaders in the Internet phenomenon. I used weekly charts to show the incredible rises in these two stocks, stocks whose action are typical of the entire group. What we see here are some of the most spectacular and flagrant parabolic rises that I've ever seen. Parabolas are movements that start slowly, curve (accelerate) ever higher -- until finally they reach the perpendicular. At which point they are ready to crash.

These stocks remind me very much of the gold action during 1980, at which time we saw gold explode and finally top out at a futures price of 875. Those top-outs finished gold for 19 years.

Once stocks crash from parabolic rises, they are usually finished for many months or even years. Therefore, it would not surprise me to see many if not most of the net stocks drop 60% to 80% over the next year of so. The rise of the net stocks characterize the intense, almost mindless bullishness which now prevails. But, at this point it looks to me as though the "net fever" has broken.

NEXT MAILING: Feb. 10, 1999




**Big-Money Breadth Index (BBI):** This is my proprietary study; it's an advance-decline line of the 10 **largest-cap stocks** in the S&P 500. The BBI turned up on Oct. 8 at 992. By Dec. 26 the BBI had climbed to a high of 1088. It then headed down -- **well ahead** of the Dow or the S&P, forming the head-and-shoulders top that you see on the chart. If the S&P is down on Monday, Jan. 25, the BBI will be breaking support; this will be a bearish indication for the entire stock market.

**LATE NOTES:** The **BBI** (above) is telling us that "big money" has been exiting the market. This is a very bearish phenomenon, since big money (the kind that buys and sells the largest cap stocks) tends to **lead** the market. Furthermore, on Friday, Jan. 22, the advance-decline ratio broke below the 4.66 "double-bottom" which was formed at the Dec. 14 and Jan. 14 lows. The Jan. 22 break-down of the A-D means that the majority of stocks on the NYSE are now **below their December lows**. If the Dow confirms, it will break below its own Dec. low of 8695.60. Since this is a primary bear market, I expect the Dow to confirm -- but in its own good time. The high for the **PTI** (see chart, page 2) was recorded on Jan. 8 at 5374. It will be important to see whether the PTI can better the 5374 high. If not -- trouble. In all, the market action this week will be critical. Weakness this week would be very bearish. Short interest on the NYSE declined 7.3% last month -- bearish. The put-call ratio holds at a bullish extreme -- bearish. Percentage of stocks on the NYSE holding above their 200-day moving average is **35%** and on the October-January rally it never pushed above 50% -- bearish.